Exploring AOL/Time Warner #15: Efficiencies in High Speed Modem/AOL-TV Software and Content Could Save \$20-30 million; Now \$910 Million-\$1.7 Billion Improvement Possible

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CA00-32

Mar 10, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult This FY	Enterprise Mult Next FY
AOL	Jun-00	O	\$59.00	-22%	\$0.17	\$0.32	\$0.58	182	105	0.0%	93	54
TWX (Time Warner)	Dec-00	O	\$85.00	18%	\$0.38	\$0.46	\$0.84	187	103	0.2%	20	17
SPX (S&P 500)			\$1,395	-5%	\$51.00	\$54.50	\$56.67	26	25			

O - Outperform, M - Market-Perform, U - Underperform

This is the fifteenth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **Combining components of software and operations of AOL TV and TW Cable Modems potentially saves in the \$20-30 million range.**
- **Early year cable modem operating costs and AOL's product development costs total an estimated \$1 billion in 2002, providing potential for savings in these (somewhat) similar offerings.**
- **A low end savings of 2% of AOL product development and early year modem operating costs would result in EBITDA savings of \$20 million. At the higher end, a 3% savings would deliver \$30 million in additional EBITDA.**
- **Savings would represent redeployment of some 130-200 personnel, principally developmental and operational personnel keeping high speed/TV operations growing and going.**
- **Our fifteen identified improvements to date provide a range of EBITDA improvement from \$909 at the low end to \$1.703 billion at the high end.**

Investment Conclusion

AOL and Time Warner are rated out perform. The growing number of possible areas for improvement makes us confident that the combined companies will be able to deliver earnings well above a pure sum-of-the-parts. As a result, the combination appears to us to make significant near and mid term operational sense, with very strong long term strategic potential as well.

Details

The Potential: High speed web content and streaming video products for Time Warner cable modems and AOL TV are, in many ways similar. Just as AOL, CompuServe, Gateway, and WalMart services all run off the same software foundations and use, in some cases, similar content, the high speed services should be able to do as well. In the case of development, the software needed to format pages, stream video, and control connections at the applications end is likely to be very similar. Systems for content presentation, and even some content, is also likely to be the same. The result is the potential for use of nearly identical software and similar content.

The Estimates: By 2002, AOL's product development costs, which include AOL TV, are estimated to be in the \$435 million range. Operating costs for cable modems at TW, including development of on-screen product and content controlling software systems (as well as distribution and operations) is estimated to be in the \$550 million range. Of this \$1 billion in costs, and estimated \$2-3% should be able to be saved, primarily in reduced manpower. At the low end, the savings would amount to a \$20 million improvement in EBITDA, with \$30 million at the high end. The bias is on the upside.

Exhibit 1 shows our current 2002 estimates for AOL product development and TW Cable Modem operating costs and the impact of savings of 2-3%. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Software Programming Savings Combining AOL TV and TW Cable Modem Services

	Low	High
AOL Product Development Costs 2002	(435)	(435)
Cable Modem Operating Costs 2002	(551)	(551)
Total Operating/Development Costs	(986)	(986)
Percent Cost Reduction	-2%	-3%
Savings in 2002	**20**	**30**
Estimated Cost per Programmer	0.150	0.150
Estimated Number of Personnel Saved	(131)	(197)

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution for AOL Discs	Savings	42	65	1-Mar-00
8	Customer Service Reps	Savings	34	68	2-Mar-00
9	Cross Selling Local Cable Ads & Digital Cities	Add'l	63	95	3-Mar-00
10	X Sell TW Cable and AOL Subscriptions	Add'l	123	185	6-Mar-00
11	Corporate Savings	Savings	35	52	7-Mar-00
12	AOL Ad & Marketing Savings w/TW Mags/Nets	Savings	100	151	8-Mar-00
13	AOL Magazine	Add'l	27	42	9-Mar-00
14	Studios Use AOL for Marketing/Promotion	Savings	48	72	10-Mar-00
15	Common Software for Cable Modems & AOLTV	Savings	20	30	13-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**909**	**1,703**	

About this project: *In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting* *for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed as broad concepts by the companies, and we will incorporate our interpretation of those where appropriate. In addition, we will initiate others ideas, when we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

FOR FAX PROBLEMS ONLY: 212-756-4263

MARCH 10, 2000

Exploring AOL/Time Warner #14: AOL/Moviefone For Warner and NewLine Studio Advertising Could Save $50-70 million; Now $890 Million-$1.67 Billion Improvement Possible

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Mar 9, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult. This FY	Enterprise Mult. Next FY
AOL	Jun-00	O	$61.00	-20%	$0.17	$0.32	$0.58	193	106	0.0%	99.1	57.3
TWX (Time Warner)	Dec-00	O	$86.88	20%	$0.38	$0.46	$0.84	188	104	0.2%	20.5	17.7
SPX (S&P 500)			$1,402	-5%	$51.00	$54.50	$56.67	27	26			

O – Outperform, M – Market-Perform, U – Underperform

This is the fourteenth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **AOL/Moviefone for Warner Studio/NewLine could provide incremental EBITDA savings in the $50-70 million range.**
- **$1.2 billion releasing budgets for studios provide room for use of AOL and Moviefone's broad reach to provide same levels of advertising at virtually no cost.**
- **A low end savings of 4% of releasing budgets would result in EBITDA savings of $48 million. At the higher end, a 6% savings would deliver $72 million in additional EBITDA.**
- **At the end of the third week of these reports, our fourteen identified improvements to date provide a range of EBITDA improvement from $889 at the low end to $1.674 billion at the high end.**

Investment Conclusion

AOL and Time Warner are rated out perform. The growing number of possible areas for improvement makes us confident that the combined companies will be able to deliver earnings well above a pure sum-of-the-parts. As a result, the combination appears to us to make significant near and mid term operational sense, with very strong long term strategic potential as well.

Details

The Potential: The combined Warner and New Line studios will be spending an estimated $1.2 billion in releasing costs by 2002, including the movies produced by others that the Warner Studio releases for a fee of about 30% of the box office. More than half of the releasing costs are for advertising and marketing. As the web in general and AOL products in particular become more important in reaching the movie-going demographics, the potential for AOL-related studio savings increases. Though it will face some competition from a theatre ticketing system (pushed by Sumner Redstone's National Amusements), AOL-owned Moviefone and its 777-FILM are expected to continue to be a major provider of tickets and movie information to consumers. The ability of the Warner Studios and New Line to increase their advertising on Moviefone could begin to offset some more conventional advertising. On the AOL proprietary service, the ability to push Warner films in advertising, with the ability to go directly to Moviefone to buy tickets, should also provide opportunities to reallocate conventional advertising and marketing spending to AOL.

The Estimates: We estimate that the total releasing costs for both Warner and New Line movies will be in the $1.2 billion range by 2002. At the low end, savings of 4% would provide incremental EBITDA improvement in the $48 million range. If 6% of advertising and marketing costs could be diverted to AOL units, then the total improvement would rise to about $72 million in EBITDA.

Exhibit 1 shows our current 2002 estimates for movie releasing costs and the potential impact of replacing some of those expenses with advertising and marketing on AOL companies. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: AOL/Moviefone Advertising/Promotion for Warner/New Line Movies

	Low	High
Warner Studio Marketing 2002 Estimate (inc Distributed Films)	(833)	(833)
New Line Studio Marketing 2002 Estimate	(363)	(363)
Total Studio Marketing Costs	(1,196)	(1,196)
Potential Savings Using AOL/Moviefone/AOL-Web Sites	4%	6%
Incremental EBITDA	**48**	**72**

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution for AOL Discs	Savings	42	65	1-Mar-00
8	Customer Service Reps	Savings	34	68	2-Mar-00
9	Cross Selling Local Cable Ads & Digital Cities	Add'l	63	95	3-Mar-00
10	X Sell TW Cable and AOL Subscriptions	Add'l	123	185	6-Mar-00
11	Corporate Savings	Savings	35	52	7-Mar-00
12	AOL Ad & Marketing Savings w/TW Mags/Nets	Savings	100	151	8-Mar-00
13	AOL Magazine	Add'l	27	42	9-Mar-00
14	Studios Use AOL for Marketing/Promotion	Savings	48	72	10-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**889**	**1,674**	

About this project: *In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed as broad concepts by the companies, and we will incorporate our interpretation of those where appropriate. In addition, we will initiate others ideas, when we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

Exploring AOL/Time Warner #12: Should Braves be Renamed "Atlanta OnLines"? Ad & Marketing Savings Add $100-150 Million to EBITDA; Improvement Range Now $814 Million-$1.56Billion

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Mar 7, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult. This FY	Enterprise Mult. Next FY
AOL	Jun-00	O	$56.00	-26%	$0.17	$0.32	$0.58	192	105	0.0%	93	54
TWX (Time Warner)	Dec-00	O	$81.19	12%	$0.38	$0.46	$0.84	187	103	0.2%	20	17
SPX (S&P 500)			$1,356	-8%	$51.00	$54.50	$56.67	26	25			

O - Outperform, M - Market-Perform, U - Underperform

This is the twelveth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **Use of Time Warner Magazine, Cable Networks, WB, & Sports could permit AOL non-disc marketing and advertising cost avoidance in the $100-150 million range.**
- **Use of vast reach of TW magazines, networks and teams for advertising could reduce need of AOL to acquire services from outside.**
- **Question: Should Atlanta Braves (ABs) change name to more politically correct Atlanta OnLines (AOLs)?**
- **At the low end, a 10% improvement of estimated billion dollar 2002 non-disc advertising and marketing budget would provide for a $100 million improvement of EBITDA. The improvement would be in the $150 million range at the high end.**
- **The range of the twelve improvements identified to date is now $814 million in incremental EBITDA at the low end to $1.56 billion at the high end.**

Investment Conclusion

AOL and Time Warner are rated out perform. The growing number of possible areas for improvement makes us confident that the combined companies will be able to deliver earnings well above a pure sum-of-the-parts. As a result, the combination appears to us to make significant near and mid term operational sense, with very strong long term strategic potential as well.

Details

The Potential: Currently, AOL's advertising and marketing budget is expected to increase at an annualized rate of 18% between FY 1999 and 2002. The result is a budget that, before disc distribution (discussed in our March 1st call) reaches just over $1 billion in 2002. About 10% of this is estimated to be true advertising, with the remainder promotional spending for everything from events to purchase subsidies. As AOL gains scale, the actual amount of advertising and marketing per subscriber is expected to decline from about $36 in 1999 to about $33 in 2002. If AOL could use Time Warner's broad based advertising and promotion platforms for image building and advertising that goes beyond pure disc distribution, then savings should accrue to the combined companies. At the most simple, AOL could be advertised in Teen People or Southern Living or the other titles. AOL ads could run on the Turner cable networks and the WB. And, while it is unlikely that Turner Stadium would be renamed AOL Stadium, the Atlanta sports teams could become a center of AOL promotion both for the crowds in person and for the television audiences across the country.

We are taken with the "Atlanta OnLines" (The AOLs) name change idea-- a far more politically correct title for the Braves.

The Estimates: In our estimates, we assumed that AOL would continue to spend the bulk of its advertising and promotion outside the Time Warner family, with heavy emphasis on purchase incentives, OEM deals and rebates to match all challengers as CompuServe has done with its successful $400 rebate. But the Time Warner facilities should be able to provide about 10 to 15% of AOL's advertising and promotional needs, resulting, at the low end, in savings in the $100 million range and of $150 million at the higher end. The bias is on the upside.

Exhibit 1 provides details of our original non-disc estimates for advertising and marketing expenses and potential reductions. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Advertising and Marketing Expense Savings

	1999	Low 2002	High 2002
AOL Advertising Budget	60	91	91
Event & Other (Non Disc) Marketing	548	913	913
Total Advertising & Marketing pre disc	608	1,005	1,005
CAGR '99-02		18%	18%
Savings Potential Pct		10%	15%
Incremental EBITDA for Non Disc Ads & Marketing		**100**	**151**
Total Advertising & Marketing pre Disc w/ Savings		904	854
CAGR '99-02 w/ Savings		14%	12%
Memo: Per Subscriber			
Total Subscribers	16.6	30.5	30.5
Current Ad and Marketing Estimate pre Discs	$ 36.65	$ 32.99	$ 32.99
Savings per Subscriber		$ 3.30	$ 4.95
New Estimate per Sub		$ 29.69	$ 28.04

Note: $200 million disc costs discussed in #7 on March 1, 1999

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution for AOL Discs	Savings	42	65	1-Mar-00

8	Customer Service Reps	Savings	34	68	2-Mar-00
9	Cross Selling Local Cable Ads & Digitial Cities	Add'l	63	95	3-Mar-00
10	X Sell TW Cable and AOL Subscriptions	Add'l	123	185	6-Mar-00
11	Corporate Savings	Savings	35	52	7-Mar-00
12	AOL Ad & Marketing Savings w/TW Mags/Nets	Savings	100	151	8-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**814**	**1,560**	

About this project: *In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed as broad concepts by the companies, and we will incorporate our interpretation of those where appropriate. In addition, we will initiate others ideas, when we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

BERNSTEIN RESEARCH CALL

MEDIA

FOR FAX PROBLEMS ONLY: 212-756-4263

MARCH 7, 2000

Exploring AOL/Time Warner #11: Corporate Savings Adds $35-50 Million to EBITDA; Improvement Range Now $715 Million-$1.41 Billion

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CA00-28

Mar 6, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult This FY	Enterprise Mult Next FY
AOL	Jun-00	O	$56.56	-25%	$0.17	$0.32	$0.58	192	105	0.0%	93	54
TWX (Time Warner)	Dec-00	O	$81.75	13%	$0.38	$0.46	$0.84	187	103	0.2%	20	17
SPX (S&P 500)			$1,391	-5%	$51.00	$54.50	$56.67	26	25			

O – Outperform, M – Market-Perform, U – Underperform

This is the eleventh in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger. Correction: The headline in our March 6th analysis of cross selling cable and AOL read that high end savings estimates had reached $1.6 billion. It should have read $1.36 billion. The text was correct.

- **Corporate cost avoidance from the merger of AOL and Time Warner could save in the $35-50 million range.**
- **By combining corporate functions such as legal, treasury, purchasing, government operations, investor relations, and corporate accounting, the four year corporate growth CAGR is estimated to drop from 8% to the 2-4% range.**
- **At the low end, this would provide for an improvement of 2002 EBITDA by $35 million. The improvement would be in the $52 million range at the high end.**
- **The range of the ten improvements identified to date is now $713 million in incremental EBITDA at low end to $1.41 billion at high end.**

Investment Conclusion

AOL and Time Warner are rated out perform.

The growing number of possible areas for improvement makes us confident that the combined companies will be able to deliver earnings well above a pure sum-of-the-parts. As a result, the combination appears to us to make significant near and mid term operational sense, with very strong long term strategic potential as well.

Details

The Potential: Corporate savings come with every merger. Often the new corporate costs of the combined companies are only slightly above those of the acquiring party. For AOL Time Warner there are corporate savings, but we expect them not to be as dramatic as in other cases. The reason is that AOL is not a media conglomerate and most of its corporate costs are related to running the company. Those costs will not go away. The potential in this merger is in combination of the true central operations of the companies: functions such as corporate legal, treasury, purchasing, government operations, investor relations, central human relations and corporate accounting. No savings will occur, for example, in the legal units that do the rights or distribution deals for either AOL or TW Cable.

The Estimates: We had estimated that AOL would continue to see rapid growth of corporate overhead as size, lobbying, and public relations efforts escalated. Time Warner, in comparison, has been running a tight corporate operation befitting a mature media company. When the two sets of estimates were combined, we had expected about 8% annualized growth between 1999 and 2002, from $280 million total corporate costs in FY '99 (AOL not adjusted to match Time Warner's calendar year) to about $350 million in 2002. At the low range, merger cost avoidance is estimated in the 10% range, saving $35 million and reducing the four year in half CAGR to 4%. At the high end, cost avoidance is estimated in the 15% range, with CAGR halved again to 2%. High end savings are estimated in the $52 million range.

Exhibit 1 provides details of our original corporate cost estimates and potential reductions. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Corporate Savings in Merger

				Low	High
	1999	2000	2001	2002	2,002
Corporate Estimates					-
AOL	120	138	159	175	175
		15%	15%	10%	10%
Time Warner	160	165	170	175	175
		3%	3%	3%	3%
Total Corporate	280	303	328	349	349
CAGR '99-02				8%	8%
Estimated Pct Savings				10%	15%
Improved EBITDA				**35**	**52**
New Corporate Estimate	280			314	297
CAGR '99-02				4%	2%
Note: Uses Original Fiscal Years					

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
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8	Customer Service Reps	Savings	34	68	2-Mar-00
9	Cross Selling Local Cable Ads & Digitial Cities	Add'l	63	95	3-Mar-00
10	X Sell TW Cable and AOL Subscriptions	Add'l	123	185	6-Mar-00
11	Corporate Savings	Savings	35	52	7-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**713**	**1,409**	

***About this project**: In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed as broad concepts by the companies, and we will incorporate our interpretation of those where appropriate. In addition, we will initiate others ideas, when we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

Exploring AOL/Time Warner #10: Cross Selling AOL and TW Cable Subscribers Adds $125-185 Million to EBITDA; Improvement Range Now $680 Million-$1.6 Billion

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Mar 3, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult This FY	Enterprise Mult Next FY
AOL	Jun-00	O	$57.75	-24%	$0.17	$0.32	$0.58	192	105	0.0%	93	54
TWX (Time Warner)	Dec-00	O	$82.56	14%	$0.38	$0.46	$0.84	187	103	0.2%	20	17
SPX (S&P 500)			$1,409	-4%	$51.00	$54.50	$56.67	26	25			

O – Outperform, M – Market-Perform, U – Underperform

This is the tenth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **In one of the largest yet identified potential improvements for the combined AOL/Time Warner, use of AOL to sell in TW Cable subscriptions and TW Cable to sell AOL could deliver additional EBITDA in the $125-$185 million range.**
- **An estimated 1 million AOL subscribers in TW Cable territory don't take TW cable while 8 million TW Cable subs don't take AOL, providing cross selling opportunity.**
- **Assuming a 10% bundling incentive discount to the normal EBITDA per sub, cross selling to increase the take rate in non-cable AOL subs and non-AOL among cable subs by 10% would deliver $123 million in incremental EBITDA. A 15% increase would deliver $185 million.**
- **About three quarters of the improvement accrues to the traditional AOL business because of TW Cable's higher levels of penetration (62%) than AOL (27%) in TW Cable territory.**
- **The range of the ten improvements identified to date is now $678 million in incremental EBITDA at low end to $1.357 billion at high end.**

Investment Conclusion

AOL and Time Warner are rated out perform.

The growing number of possible areas for improvement makes us confident that the combined companies will be able to deliver earnings well above a pure sum-of-the-parts. As a result, the combination appears to us to make significant near and mid term operational sense, with very strong long term strategic potential as well.

Details

The Potential: In our project, we have explored the cross selling of AOL and magazine subscriptions ((Feb 23rd), but we have not looked at the potential for AOL and Cable to sell each other's products within Time Warner cable territory. Both companies have solid subscriber relationships within the 13 million TW Cable subscribers (2002 estimate) and 8.2 million AOL subs estimated to be in the same geographical territory by 2002. As a result, Cable and AOL should be able to provide incentives to cross sell each others' basic products.

The Estimates: There are two parts to this cross selling estimate. Selling cable to AOL subs and selling AOL to cable subs. In our estimate for selling cable subscriptions, we only took into account the AOL slow speed subscribers, figuring that there was a high probability that high speed subs (either DSL or cable modem) would already have cable service. We have previously estimated that about 6.7 million AOL slow speed subscribers are in TW Cable territory, and there is also a fairly high likelihood that these AOL subscribers will be taking cable service, too. We estimate that 85% of AOL subs are cable subscribers as opposed to 62% of all households. Therefore about 1 million AOL slow speed subs don't take cable. Assuming a 10% discount to the 2002 estimated EBITDA per cable sub before phone and data services (to cover free HBO or other incentives), then a 10% conversion of the AOL subs that don't take cable would add $20 million to EBITDA. A 15% conversion rate would add $30 million.

Much better results are seen if TW Cable subscribers that don't take AOL could be converted into AOL subs. In 2002, we estimate that AOL will have a total of about 30.5 million traditional and high speed subscribers, which skew heavily into more urban Time Warner Cable territories. (Estimated at 27% vs. 20% TW Cable coverage of the nation as a whole.) That means there are about 8 million AOL subs in Time Warner Cable territory by 2002, leaving 13 million of the 21 million TW Cable Homes passed without AOL service. Time Warner Cable penetration is estimated at 62%, suggesting that about 8 million TW Cable subscribers do not take AOL, and therefore are ripe for conversion. Again, we assumed a 10% incentive discount to the $139 average EBITDA per AOL subscriber in 2002 (including all subscription, advertising, e-commerce and ancillary revenues). At a 10% conversion rate, 800 thousand new AOL subscribers would be added, delivering $103 million in incremental EBITDA. If the conversion rate rises to 15%, the incremental addition would be $155 million.

When the conversion of AOL subscribers to TW Cable and TW Cable subscribers to AOL are combined, the incremental EBITDA is in the $123 to $185 million range.

Exhibit 1 provides details on how we calculated incremental EBITDA for AOL and TW Cable subscriber conversions.. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Cross Selling Cable to AOL and AOL to Cable

Selling Cable Subscriptions		
AOL Slow Speed Subs in TW Territory (mil)	6.7	6.7
Pct AOL Subs Taking TW Cable Services	85%	85%
AOL Subs Not Taking TW Cable (mil)	1.00	1.00
Pct AOL Subs Sold TW Cable	*10%*	*15%*
New TW Cable Subs (mil)	0.100	0.150
EBITDA per Sub	$221	$221
Less Bundling Incentives	10%	10%
Incremental EBITDA per New Cable Sub	$199	$199
AOL Subs Sold TW Cable Add'l EBITDA ($ mil)	**20**	**30**
Selling AOL Subscriptions		
AOL Subs in 2002 (mil)	30.5	30.5
Pct AOL Subs in TW Territory	27%	27%
AOL Subs in TW Territory (mil)	8.2	8.2
TW Homes Passed in 2002 (mil)	21.4	21.4
Pct TW HP Not Taking AOL	62%	62%
TW Homes Passed Not Taking AOL (mil)	13.2	13.2
TW Cable Penetration of Homes Passed	62%	62%
TW Subs Not Taking AOL (mil)	8.2	8.2
Pct TW Cable HP Not Taking AOL Sold AOL	*10%*	*15%*
New AOL Subs (mil)	0.8	1.2
EBITDA per AOL Sub	$139	$139

Less Bundling Incentives	10%	10%
Incremental EBITDA per New AOL Sub	$125	$125
TW Cable HP Sold AOL Incremental EBITDA ($mil)	**103**	**155**
Cable/AOL X Selling Incremental EBITDA ($mil)	**123**	**185**

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution for AOL Discs	Savings	42	65	1-Mar-00
8	Customer Service Reps	Savings	34	68	2-Mar-00
9	Cross Selling Local Cable Ads & Digital Cities	Add'l	63	95	3-Mar-00
10	X Sell TW Cable and AOL Subscriptions	Add'l	123	185	6-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**678**	**1,357**	

About this project: *In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed as broad concepts by the companies, and we will incorporate our interpretation of those where appropriate. In addition, we will initiate others ideas, when we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

Exploring AOL/Time Warner #9: Digital Cities/Local Cable Benefit from Cross Selling Local Advertising; Adds $65-95 Million to EBITDA; At End of Second Week of Study Improvement Range Now $555 Million-$1.17 Billion

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Mar 2, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult. This FY	Enterprise Mult. Next FY
AOL	Jun-00	O	$56.00	-26%	$0.17	$0.32	$0.58	177	97	0.0%	90.8	52.4
TWX (Time Warner)	Dec-00	O	$82.69	14%	$0.38	$0.46	$0.84	179	99	0.2%	19.6	16.9
SPX (S&P 500)			$1,382	-6%	$51.00	$54.50	$56.67	27	25			

O – Outperform, M – Market-Perform, U – Underperform

This is the ninth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **Cross-selling local advertising between TW Cable and AOL Digital Cities could deliver EBITDA improvements in the $65-$95 million range.**
- **As local cable ad sales continue to move to compete with other local media, addition of DigitalCities web operations to local sale could result in premium to cable sales.**
- **Assuming 75% incremental margin, a 10% increase in combined estimated 2002 local cable and Digital Cities ad sales would result in addition of estimated $65 million in EBITDA to combined companies; high end 15% improvement would deliver about $95 million additional.**
- **At end of second week of our revenue/savings project, the range of the nine improvements is now $555 million at low end to $1.17 billion at high end.**

Investment Conclusion

As we end the second week of identifying potential revenue and cost improvements for the combined AOL-Time Warner, the growing number of possible areas for improvement makes us confident that the combined companies will be able to deliver earnings well above a pure sum-of-the-parts. As a result, the combination appears to us to make significant near and mid term operational sense, with very strong long-term strategic potential as well. Both AOL and Time Warner are rated out perform.

Details

The Issue: AOL and Time Warner both have growing local advertising operations. Time Warner has the largest in its cable operations, where cable ad sales are not gaining the ability to compete with other local media—television stations, radio and newspapers—because of the consolidation and resorting of the cable business by market. At AOL, Digital Cities is providing local web content and a growing amount of local advertising. Digital Cities is selling local advertising now using a time pressure component—saying that it has, for example, just nine slots for local auto dealers and the section closes on Friday. For $50,000, your auto dealership can advertise for six months in one of those slots. Six months later, assuming AOL's normal overdelivery, both the number of slots and the price goes up. But even with these new selling techniques and despite huge growth percentages from a low base, local web advertising is likely to develop slowly against entrenched broadcasting and newspaper competitors, just as cable was.

The Potential: If some of the advertising of the two—cable and web—can be sold together on a local basis, then the web advertising component stands to see improvement in sales. The same local advertisers who are involved in cable advertising are likely to be interested in advertising on the web, but need a push that will make them feel safe. As we have discussed in previous pieces of this series, advertising on one medium can be guaranteed on another, so a local advertiser could purchase both cable and web messages, with the guarantee that, if the web doesn't work for him, he could receive make good spots on cable.

The Estimates: Our current estimates for Time Warner cable's local ad sales in 2002 are just under $800 million. At that point Digital Cities will still be receiving a relatively small amount of advertising, estimated at $50 million in Time Warner cable territory. Incremental advertising revenues are expected to see 75% margins. At the low end, we estimated that selling Digital Cities along with cable would increase the combined ad revenues by 10%, delivering about $63 million in additional EBITDA to the combined companies. For the high end the additional EBITDA would be in the $95 million range.

Exhibit 1 provides details of how we calculated high and low range savings for CSR reductions. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Cross Selling Time Warner Cable and Digital Cities Local Advertising

	Low	High
Current Estimated Local Cable Revenue 2002	794	794
Estimated Digital Cities Local Revenues In TW Cable Territory	50	50
Total Local Revenues	844	844
Potential Improvement Cross Selling	10%	15%
Additional Local Revenues ($ mil)	84	127
Incremental Margin	75%	75%
EBITDA Improvement	**63**	**95**
Memo:		
Improvement as Pct of Cable Ad Sales Revenues	8%	11%
Improvement as Pct of Digital Cities Ad Sales Revenues	169%	253%

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution for AOL Discs	Savings	42	65	1-Mar-00
8	Customer Service Reps	Savings	34	68	2-Mar-00
9	Cross Selling Local Cable Ads & Digital Cities	Add'l	63	95	3-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**555**	**1,172**	

About this project: *In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed as broad concepts by the companies, and we will incorporate our interpretation of those where appropriate. In addition, we will initiate others ideas, when we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

FOR FAX PROBLEMS ONLY: 212-756-4263

MARCH 2, 2000

Exploring AOL/Time Warner #8: Combined Customer Service Reps Saves $40-65 Million EBITDA; Improvement Range Now $490 million-$1.08 Billion

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Mar 1, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult- This FY	Enterprise Mult- Next FY
AOL	Jun-00	O	$56.75	-20%	$0.17	$0.32	$0.58	192	105	0.0%	98.2	56.8
TWX (Time Warner)	Dec-00	O	$84.38	20%	$0.38	$0.46	$0.84	187	103	0.2%	20.5	17.6
SPX (S&P 500)			$1,379	-8%	$51.00	$54.50	$56.67	26	25			

O – Outperform, M – Market-Perform, U – Underperform

This is the eighth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **Personnel efficiencies in estimated 9,000 customer service representatives at AOL/TimeWarner could in $35-$70 million range.**
- **Use of overlapping CSRs for two companies could result in 5-10% savings in personnel and related overhead.**
- **Low end estimate 5% reduction in overlapping CSRs would result in $34 million in EBITDA additions; 10% reduction would save $68 million.**
- **Identified EBITDA savings and revenue improvements to date now $490 million at low end to $1.08 billion at high end.**

Investment Conclusion

The AOL-Time Warner combination appears to us to make significant strategic and operational sense, and both companies are rated out perform. However the scale of the deal coupled with the varied Street orientations toward both companies make development of consensus difficult. This is made even more so as the companies themselves spend this early post-deal period talking about ideas at the strategic or even cosmic levels—the only thing they can do right now as the work out the practical nuts and bolts of running the companies and finding new revenues and savings in the existing businesses.

We buy into AOL CEO Bob Pittman's concept of a pyramid for the benefits of the merger, with operating efficiencies at the bottom, strategic ideas in the middle like the use of AOL to download TimeWarner's (and other) music libraries to online users, and with totally new ways to use online services at the top. The strategic and cosmic levels will develop, but it is the operating efficiencies that will get this merger through the next couple of years, and we are trying to focus on those in this series.

Details

The Issue: AOL and Time Warner both use a lot of customer services representatives. We estimate 6000 at AOL and half that at Time Warner. The CSRs do everything from taking AOL and Time Warner magazine orders to solving computer and cable problems, to answering "per inquiry" calls for sales orders on the Turner networks.

The Potential: Reduction of some of the CSRs may be possible due to overlapping, staffing, and potential dual-use as the companies are combined

The Estimates: We estimate that CSRs cost the companies about $75,000 when salaries, benefits, management, facilities and other overhead are counted. If savings 5% of the estimated 9000 CSRs can be found, then the benefit to the combined companies is in the $34 million range. 10% would save about $68 million in EBITDA.

Exhibit 1 provides details of how we calculated high and low range savings for CSR reductions. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Packaging AOL Discs With TW Magazines and Music; Manufacturing at TW Disc Plants

	Low	High
Estimated Customer Service Reps AOL	6,000	6,000
Estimated Customer Service Reps TW	3,000	3,000
Total CSRs	9,000	9,000
Estimated All-In Cost per CSR ($)	75,000	75,000
Total CSR Costs ($ mil)	675	675
Combined AOL/TW Potential Savings Pct.	5%	10%
Potential CSR Savings ($ mil)	**34**	**68**
Memo:		
Estimated AOL CSR Costs	450	450
Combined Savings as Pct of AOL Costs	8%	15%
Estimated TW CSR Costs	225	225
Combined Savings as Pct of TW Costs	15%	30%

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution for AOL Discs	Savings	42	65	1-Mar-00
8	Customer Service Reps	Savings	34	68	2-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**492**	**1,077**	

About this project: *In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we* *are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed by the company, and we will incorporate those where appropriate. We will initiate others ideas, if we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

FOR FAX PROBLEMS ONLY: 212-756-4263

MARCH 1, 2000

Exploring AOL/Time Warner #7: Packaging AOL Discs With TW Magazines & Music Saves $40-65 Million EBITDA; Improvement Range Now $460 million-$1.01 Billion

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Feb 29, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult. This FY	Enterprise Mult. Next FY
AOL	Jun-00	O	$58.95	-20%	$0.17	$0.32	$0.58	192	105	0.0%	98.2	56.8
TWX (Time Warner)	Dec-00	O	$85.25	20%	$0.38	$0.46	$0.84	187	103	0.2%	20.5	17.6
SPX (S&P 500)			$1,366	-8%	$51.00	$54.50	$56.67	26	25			

O – Outperform, M – Market-Perform, U – Underperform

This is the seventh in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **Use of Time Warner magazine and music distribution plus manufacturing for AOL discs could save in $40-$65 million range.**
- **Per-disc savings of 10% estimated $0.75 unit/package cost or $7.5 million using TW music pressing/packaging plants.**
- **Per-disc savings of 90% of estimated $1.25 average distribution/ad insertion/postage costs using estimated *one billion* TW magazine and music units delivered per year.**
- **Low end estimate 3% of TW distribution units used for 30% of AOL discs, or $42 million in EBITDA savings; high end 5% of TW units for half AOL discs for $65 million in savings.**
- **Identified EBITDA savings and revenue improvements to date now $460 million at low end to $1.01 billion at high end.**

Investment Conclusion

The AOL-Time Warner combination appears to us to make significant strategic and operational sense, and both companies are rated out perform. However the scale of the deal coupled with the varied Street orientations toward both companies make development of consensus difficult. This is made even more so as the companies themselves spend this early post-deal period talking about ideas at the strategic or even cosmic levels—the only thing they can do right now as the work out the practical nuts and bolts of running the companies and finding new revenues and savings in the existing businesses.

We buy into AOL CEO Bob Pittman's concept of a pyramid for the benefits of the merger, with operating efficiencies at the bottom, strategic ideas in the middle like the use of AOL to download TimeWarner's (and other) music libraries to online users, and with totally new ways to use online services at the top. The strategic and cosmic levels will develop, but it is the operating efficiencies that will get this merger through the next couple of years, and we are trying to focus on those in this series.

Details

The Issue: At AOL, the company carpet bombs the US with an estimated 100 million discs per year, enough to reach every household and more than a third of the population of the country. We estimate that the average cost for these discs is about $2 each, including an estimated $0.75 in manufacturing and packaging and another $1.25 average for the combination of ad insertion, postage, shipping, plastic newspaper bags, and the host of other creative ways the pesky discs show up in our lives. In total, we estimate disc distribution costs are in the $200 million range—part of AOL's marketing costs.

The Potential: If TimeWarner's manufacturing processes can be used to make and package discs, and if TimeWarner's magazine and music distribution can be used to circulate some of the discs as part of the magazine and music packages, then the net result is a significant reduction in the number of discs AOL has to distribute in its conventional, and more costly way. . We estimate that each year Time Warner sends out some 1 billion separate magazines or music discs in the US. This number will increase with the growth of DVD.

The Estimates: From Time Warner we have estimated that savings of 10% could be seen in the estimated $0.75 per disc production and packaging costs. Across 100 million discs, this is about $7.5 million. The greater benefit comes in actually packaging the discs with magazines and music. If the AOL discs were packaged with the individual magazines or music discs, then the current distribution estimated $1.25 per disc distribution costs could be saved. At the low end, we estimate that only 3% of the Time Warner magazine/music units are used, accounting for about 30% of AOL disc distribution. This would save about $34 million plus the $7.5 million in manufacturing. At the high end, we estimated just 5% of the Time Warner distribution capacity is used for 50% of AOL discs, for savings on distribution of $57 million, or about $65 million when the manufacturing savings are factored in.

Additional savings could come by actually pressing the AOL software in with music CDs and DVD discs, though this begins to raise some problems with retailers and others who may not be overly generous to AOL—like Kmart, for example. However, it would be easy to do special pressings for TW music distributed in WalMart, which does have a distribution deal with AOL.

Exhibit 1 provides details of how we calculated high and low range savings by using TW music and magazine facilities to distribute AOL discs. Exhibit 2 shows the to-date results of our project to identify potential cost savings, cost avoidance, and new revenues made possible as a result of the AOL/Time Warner merger.

Exhibit 1: Packaging AOL Discs With TW Magazines and Music; Manufacturing at TW Disc Plants

	Low	High
Estimated Discs Distributed (mil)	100	100
Disc Physical Costs inc Packaging	$0.75	$0.75
Postage, Ad Insertions, Other Dist Costs	$1.25	$1.25
Average Cost per Disc Inc Distribution	$2.00	$2.00
Disc Distribution Costs ($mil)	200	200
Potential Alternative Distribution		
Magazine Units Sold Annual (mil)	800	800
Music Units Shipped US Annual (mil)_	215	215
Total TW Units Shipped per Year	1015	1015
Savings		
Physical Costs Pct Using TW Production	10%	10%
Unit Savings per Disc Manufactured by TW	$0.08	$0.08
Pct of Discs Manufactured by TW	100%	100%
Savings on TW Manufactured Discs	7.5	7.5
Pct Savings Postage, Ad Insert, Other Costs	90%	90%
Unit Savings Postage, Ad Insert, Other	$1.13	$1.13
Pct TW Units Used for AOL Distribution	3%	5%
TW Units Used for Distribution	30	51
Pct of AOL Distribution	30%	51%
Savings on Distribution	34	57
Total Savings per Disc Distributed	$1.20	$1.20
AOL Disc Savings ($mil)	**42**	**65**

Exhibit 2: To Date Summary of Ongoing Merger Related Savings and Additional Revenues

Number	Area	Savings or Add'l Revenue	Low ($mil)	High ($mil)	Date of SCB Call
1	Heavy AOL Users Connect in TWX Territory	Savings	50	100	22-Feb-00
2	Cross Selling of AOL Svce/TWX Magazines	Add'l Rev	100	280	23-Feb-00
3	Personnel & Op Efficiencies in TWX Web Svcs	Savings	101	143	24-Feb-00
4	Cross Selling of AOL/TWX Advertising	Add'l	90	207	25-Feb-00
5	Music Flop Avoidance	Savings	28	68	28-Feb-00
6	AOL Markets TW Cable High Speed Service	Add'l	46	147	29-Feb-00
7	TW Distribution/Manufacturing for AOL Discs	Savings	42	65	1-Mar-00
Total	**Total Savings, Avoidance, and Add'l Revenues**		**458**	**1,009**	

***About this project**: In our combined estimates for AOL and Time Warner we have yet to incorporate new revenues or cost savings that potentially result from the deal. The reason is that we were burned by company assurances of early synergies in several previous media mega-mergers, specifically Disney/CapCities and Viacom/Paramount/Blockbuster. In those cases, we simply added in a "synergies" line after combining the other parts of the companies. Inaccuracy in the first year synergy line, later year growth, and reconciling the synergy line with future company reports all left the process wanting for accuracy. As a result, we are taking a different, and slower approach to recognizing improved revenues and cost savings that result from the AOL/Time Warner merger. As ideas surface we will try to quantify the potential improvements within a range. We will then keep a running total of the ideas until individual approaches begin to look certain enough to include in our company estimates. Instead of waiting for one major call to wrap up a lot of these possible areas, we will be publishing them as they emerge and appear feasible. Some will be discussed by the company, and we will incorporate those where appropriate. We will initiate others ideas, if we have them. The ideas will not be in any particular order, but we will use a minimum of $25 million improvement as a high end requirement.*

Exploring AOL/TimeWarner #6: Marketing AOL Subs To TW High Speed Data Could Add $45-145 Million; $415-945 Million Add'l EBITDA Potential Identified

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Feb 28, 2000	This FY Ends	Rating	Close	YTD Perf	EPS Last FY	EPS This FY	EPS Next FY	P/E This FY	P/E Next FY	Yield	Enterprise Mult This FY	Enterprise Mult Next FY
AOL	Jun-00	O	$60.50	-20%	$0.17	$0.32	$0.58	192	105	0.0%	98.2	56.8
TWX (Time Warner)	Dec-00	O	$86.69	20%	$0.38	$0.46	$0.84	187	103	0.2%	20.5	17.6
EMI (EMI Group)	Mar-00	O	£7.00	15%	£0.25	£0.26	£0.28	27	25	2.3%	19.0	17.4
SPX (S&P 500)			$1,348	-8%	$51.00	$54.50	$56.67	26	25			

O – Outperform, M – Market-Perform, U – Underperform

This is the sixth in a continuing series to explore and quantify potential new revenues and cost savings that we believe are likely to result from the AOL-Time Warner Merger.

- **Use of AOL Subscriber Base to market high speed Time Warner Cable Service could add $45-145 million in ongoing EBITDA to combined companies.**
- **Conversion of AOL subs to Time Warner High Speed data subscribers to improve estimated 2002 high speed data penetration to 20% from current 15% estimate would add $45 million to EBITDA in 2002 with no margin improvement.**
- **If Half of AOL subscribers in Time Warner territory were to take high speed service by 2002 (assuming 20% already will at that point), the incremental improvement would estimated in the $145 million range. One third of TW data ready subscribers would be taking high speed data to meet this estimate.**
- **Success in cross marketing Time Warner high speed data to AOL subscribers would have residual value as combined company would use its TW results to encourage other cable companies to sign on.**
- **With the latest high speed data numbers included, our ongoing project to identify new revenues, cost savings and cost avoidance in the combined companies now ranges between $415 million in EBITDA at the low end and $945 million on the high end. These are all ongoing savings that will continue year to year.**

Investment Conclusion

The AOL-Time Warner combination appears to us to make significant strategic and operational sense, and both companies are rated out perform. However the scale of the deal coupled with the varied Street orientations toward both companies make development of consensus difficult. This is made even more so as the companies themselves spend this early post-deal period talking about ideas at the strategic or even cosmic levels—the only thing they can do right now as the work out the practical nuts and bolts of running the companies and finding new revenues and savings in the existing businesses.

We buy into AOL CEO Bob Pittman's concept of a pyramid for the benefits of the merger, with operating efficiencies at the bottom, strategic ideas in the middle like the use of AOL to download TimeWarner's (and other) music libraries to online users, and with totally new ways to use online services at the top. The strategic and cosmic levels will develop, but it is the operating efficiencies that will get this merger through the next couple of years, and we are trying to focus on those in this series.

Details

The Potential: We currently estimate that by 2002, about 15% of Time Warner's available cable subscribers will be taking high speed data services from the company. If the penetration rates can be increased through conversion of